

## Message Text

CONFIDENTIAL

PAGE 01 LIMA 09304 110802Z

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ACTION ARA-06

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C O N F I D E N T I A L LIMA 9304

LIMDIS

FOR ARA - WILLIAM ROGERS; L - MARK FELDMAN; EB - THOMAS ENDERS,  
TREASURY - JOHN BUSHNELL; CIEP - WAYNE SHARPE; COMMERCE - DAN  
ARRILL

EO 11652: GDS

TAGS: EIND, EINV, EMIN, PFOR, PE

SUBJECT: MARCONA - MEETING WITH COMMISSION

REF: LIMA 9303

1. SUMMARY: U.S. GROUP MET FOR TWO AND A HALF HOURS WITH  
GOP COMMISSION (SAME GROUP AS BEFORE BUT AUGMENTED BY RUBINS  
OF MINPECO). WHILE HOLDING TO BOOK VALUE BASIS, COMMISSION  
OBVIOUSLY PREPARED TO DISCUSS INDIRECT MEANS OF COMPENSATION,  
SOMEWHAT TAKEN ABACK BY MARCONA'S DOLLAR BOOK VALUE, YET  
APPARENTLY WILLING AT LEAST TO TALK ABOUT TOTAL COMPENSATION  
FIGURES IN THE \$45-49 MILLION RANGE. COMMISSION NOW UNDER-  
STANDS ORDER OF MAGNITUDE OF SETTLEMENT LIKELY TO BE ACCEPTABLE  
TO MARCONA (AS ILLUSTRATED BY NEGOTIATING STANCE OF NET BOOK  
VALUE OF \$83 MILLION PLUS ONGOING PROFITS). BETWEEN NOW AND  
TUESDAY AFTERNOON, GOP WILL BE DECIDING WHETHER IT IS STILL  
INTERESTED IN A PROMPT SETTLEMENT. END SUMMARY

2. DE LA PUENTE BEGAN BY NOTING CLOSE TIES BETWEEN  
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PAGE 02 LIMA 09304 110802Z

COMMISSION AND CABINET MINISTERS; ALL ARE INVOLVED AND

HAVE BEEN KEPT FULLY INFORMED. PRINCIPAL CONCERN OF GOP IS THE FRAMEWORK FOR A SETTLEMENT; IT HAS TWO OVER-RIDING ELEMENTS, THE DECREE LAW ON MARCONA NATIONALIZATION AND THE ASSET VALUATION PROCEDURE. THE FIGURES GOP HAS RAISED DIFFER MARKEDLY FROM THOSE DISCUSSED LAST TIME BY THE USG, AND THESE DIFFERENCES MUST BE DISCUSSED. HE REITERATED THE HIGHLY POLITICAL NATURE OF PROCESS AND THE POLITICAL COST TO PERU OF ANY SETTLEMENT, AND ASKED THE U.S. GROUP WHETHER IT HAD REEXAMINED THE \$119 MILLION FIGURE PRESENTED TWO WEEKS EARLIER?

3. FISHLOW INDICATED HIS AWARENESS OF THE POLITICAL ENVIRONMENT; YET WHILE WE CANNOT LIMIT OURSELVES TO TECHNICAL CONSIDERATIONS THESE ARE VERY IMPORTANT. OUT EMPHASIS ON GOING CONCERN VALUE REFLECTS NOT ONLY USG POLICY BUT THE PERUVIAN LAW FOR VALUING MINING PROPERTIES. THE HOSKOLD FORMULA, HE CONTINUED, ACTUALLY IS NOT AS AFVORABLE AS IT MIGHT BE TO MARCONA BECAUSE MARCONA HS THE BULK OF ITS ASSETS IN MANUFACTURING (PELLETS) RATHER THAN MINING PER SE. WE MUST EVALUATE MARCONA ON THE BASIS OF ITS STATUS AS AN ONGOING ENTERPRISE WITH AN ABILITY TO EARN INCOME OVER THE LIFE OF THE CONCESSION. TODAY WE HOPE TO LOOK FURTHER AT THE GOP'S BOOK-VALUE-BASED ANALYSIS, WHILE TOMORROW WE CAN DISCUSS OUR OWN CALUCLATIONS FURTHER. FOR NOW, WE WISH TO REFER TO CERTAIN CALCULATIONS RELATING TO BOOK VALUE, NOT BECAUSE WE ACCEPT BOOK VALUE--WE DO NOT-- BUT IN ORDER TO CLARIFY THE ISSUES.

3. FISHLOW THEN DISCUSSED MARCONA'S JULY 25, 1975 BALANCE SHEET WHICH SHOWS NET ASSET VALUE OF THE MINING ENTERPRISE AT ABOUT \$83 MILLION. HE INDICATED HOW THIS WAS WRITTEN OFF FOR TAX PURPOSES BY MARCONA. THER WAS A TAX RESERVE REDUCTION OF \$30.4 MILLION BECAUSE IT WAS NO LONGER REQUIRED TO OFFSET POTENTIAL REPATRIATIION OF INCOME FROM SALES AND SHIPPING SUBSIDIARIES. THE LATTER, HE CONCLUDED, DOES NOT AFFECT THE NET ASSET VALUATION OF \$83 MILLION, A FIGURE THAT DIFFERS SUBSTANTIALLY FROM THE GOP'S BOOK VALUE FIGURES. HE ALSO EXPLAINED THE ACCOUNTING TRANSACTIONS THAT LED CYPRUS MINES AND UTAH MINING TO WRITE OFF THEIR PROPORTION OF THE \$52.5 MILLION (\$83 MIL-  
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 LIMA 09304 110802Z

LION LESS \$30 MILLION), LESS THEIR OWN TAX RESERVES FOR EXPECTED FITURE MARCONA DIVIDENDS. (FOR CYPRUS, THE \$24 MILLION WAS REDUCED BY \$10 MILLION, FOR UTAH, BY \$5 MILLION.)

4. AFTER SOME QUESTIONS ON THE FIGURES FISHLOW NOTED THAT IN CERTAIN PAST SETTLEMENTS, INCLUDING SOME IN LATING AMERICA, U.S. COMPANIES HAVE ACCEPTED SETTLEMENTS CONSISTING OF NET BOOK VALUE PLUS AN ONGOING RELATIONSHIP THAT PROVIDES AN

ADDITIONAL MEASURE OF PROFIT. WHERE SUCH ARRANGEMENTS ARE ACCEPTABLE TO THE COMPANIES, THE USG HAS NOT OBJECTED. HE THEN SUGGESTED THE DESIRABILITY, AS TWO GROUPS LOOK FOR A BASIS OF SETTLEMENT, OF FOCUSING ON ALTERNATIVES TO ALUMP SUM AS A BASIS FOR BRIDGING THE GAP. WE OFFERED NO SPECIFIC PROPOSAL AT THIS TIME, BUT NOTED THAT SOME SORT OF ONGOING RELATIONSHIP WOULD HAVE THE ADDITIONAL ADVANTAGE OF PERMITTING AN IMMEDIATE RESUMPTION OF SALES, ENABLING THE GOP TO REALIZE PROMPTLY THE VALUE OF ITS ACCUMULATING INVENTORIES. THE GOP WILL INEVITABLY EXPERIENCE DELAYS IN OBTAINING NEW CONTRACTS. THE PRESENT RECESSIONALY PERIOD HAS REDUCED STEEL PRODUCTION AND IN ANY EVENT PERU ONLY PRODUCES A SMALL FRACTION OF WORLD ORE OUTPUT. THIS THERE WOULD BE CONSIDERABLE ADVANTAGES TO ARRANGEMENTS WHICH PERMITTED MARCONA TO FULFILL EXISTING CONTRACTS. UNDER THESE CIRCUMSTANCES MARCONA MIGHT BE WILLING TO OFFER LOWER SHIPPING RATES AND COMMISSIONS IF GOP AGREES TO PAY A PERCENTAGE OF THE FOB ORE VALUE TOWARD COMPENSATION FOR THE FACILITY NATIONALIZED BY THE GOP. U.S. GROUP NOTED THAT WE AS WELL AS GOP WERE CONCERNED WITH GOP'S ECONOMIC DEVELOPMENT AND THOUGHT IT WOULD BE A TRAGEDY IF THIS FACILITY WITH A CAPACITY TO EARN \$150 MILLION IN FOREIGN EXCHANGE ANNUALLY WERE ALLOWED NOT TO DO SO FOR WANT OF A RAPID SETTLEMENT. THE USG IS PREPARED TO WORK WITH THE GOP TO FIND AN EQUITABLE SOLUTION THROUGH FAIR MECHANISMS.

5. DE LA PUENTE INDICATED WILLINGNESS TO DISCUSS SOME SORT OF ONGOING RELATIONSHIP. WAS THE USG SUGGESTING THAT A SETTLEMENT MIGHT, FOR EXAMPLE, CONSIST OF A \$20 MILLION PAYMENT PLUS ANOTHER \$25 MILLION DERIVED FROM A \$0.50 PER TON FREIGHT CHARGE (AT \$5 MILLION PER YEAR FOR FIVE YEARS)? FISHLOW NOTED THAT PROBLEMS RAISED BY A FREIGHT RATE BASIS IF RATES INCREASED TO ABOVE PRESENT CONTRACT

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 LIMA 09304 110802Z

PRICES; UNDER THOSE CIRCUMSTANCES THERE WOULD BE NO "COMPENSATION" HERE. IT WOULD BE BETTER TO SET ASIDE A PORTION OF FOB ORE SHIPMENTS ESPECIALLY IN THE NEAR TERM. HOWEVER, WE ARE OPEN TO ANY GOP SUGGESTIONS.

6. GOP COMMISSIONS ASKED FOR COPY OF 10-K AND OTHER FIGURES, USED IN USG ILLUSTRATIVE BOOK VALUE CALCULATIONS, WHICH ARE BEING PROVIDED. FISHLOW EMPHASIZED, IN RESPONSE TO QUESTIONS, THAT DOLLAR BOOKS ARE PROBABLY MORE ACCURATE MEASURE OF TRUE VALUE THAN SOLES ACCOUNTS, AS FIXED ASSETS WERE PURCHASED ABROAD IN DOLLARS AND IMPORTED INTO PERU. IN COURSE OF DISCUSSION OF USG GOING CONCERN FIGURES, BROUSETT INDICATED THAT ON BASIS OF PROFIT PROJECTIONS HE CAME OUT WITH A VALUE OF \$49 MILLION (WHICH HE NOTED HE WAS DISCUSSING FOR ILLUSTRATIVE PURPOSES). HE EMPHASIZED

THE FACT THAT MARCONA HAD HAD LOSSES SINCE 1971, AND WAS NOT CONVINCED BY U.S. GROUP ARGUMENTS REGARDING SPECIAL CIRCUMSTANCES, STRIKE, INCREASE IN OUL COSTS, FAILURE OF PERUVIAN EXCHANGE RESTRICTIONS TO REFLECT REALITY. FISHLOW EMPHASIZED THAT IF HISTORICAL EARNINGS/CASH FLOW METHOD FOR VALUATION IS USED SOLES AND DOLLAR BOOKS PRODUCE SIMILAR RESULTS, SINCE DIFFERENCE IN DEPRECIATION METHODS IS ELIMINATED. HE PROMISED TO PRESENT SPECIFIC FIGURES AT TUDEDAY MEETING.

7. FISHLOW SUMMARIZED THE MEETING AS FLOOWS: (A) THE USG, WITHOUT ACCEPTING THE PRINCIPLE, WILL MAKE AVAILABLE ITS FIGURES RELATING TO MARCONA'S DOLLAR BOOK VALUE; (B) IN THE PAST, U.S. COMPANIES HAVE ACCEPTED SETTLEMENTS CONSISTING OF NET BOOK VALUE PLUS ONGOING PROFIT-GENERATING RELATIONSHIP; (C) IF WE ARE TO ARRIVE AT AN APPROPRIATE MUTUALLY ACCEPTABLE SETTLEMENT WE WILL HAVE TO EXAMINE ALL DIMENSIONS OF THE PROBLEM--WE HOPE THE GOP WILL BE FLEXIBLE AND WE WILL TRY TO SHOW FELXIBILITY OURSELVES; (D) NOW THAT WE HAVE DONE SO MUCH TALING IT WILL BE HELPFUL TO US TO HAVE GOP'S CONCRETE PROPOSAL.

8. IT WAS AGREED THAT BROUSETT AND HIS ASSISTANTS WOULD MEET WITH U.S. GROUP TUESDAY MORNING TO DISCUSS FIGURES IN MORE DETAIL, WITH FULL COMMISSION MEETING TUESDAY AFTERNOON.

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PAGE 05 LIMA 09304 110802Z

9. COMMENT: IT WAS OBVIOUS THAT MERELY HAVING TOP AT THE TECHNICAL COMMISSION LEVEL RESTATE THE \$15-20 MILLION, WHICH WAS REJECTED OUTRIGHT BY FISHLOW AT MEETING WITH FOREIGN MINISTER (SEE REFTEL), WOULD WASTE TIME AND MIGHT EVEN BE COUNTERPRODUCTIVE. ON THAT BASIS, U.S. STRATEGY WAS TO CONTINUE TO RAISE SIGHTS OF GOP IN TERMS OF AMOUNT WHILE ENCOURAGING GOP TO EXPLORE PAYMENT MECHANISMS WHICH WOULD NARROW THE GAP. FOR FIRST TIME GOP COMMISSION INDICATED WILLINGNESS TO DISCUSS INDIRECT METHODS OF COMPENSATION REQUIRING ONE FORM OR ANOTHER OF ONGOING RELATIONSHIP WITH MARCONA. MOREOVER, ALTHOUGH STICKING IN THEORY TO BOOK VALUE CALCULATION THEY TWICE MENTIONED FIGURES (\$45 MILLION AND \$49 MILLION) WHICH ARE BEYOND UPPER LIMITS JUSTIFIABLE BY THEIR BOOK BALUE CALCULATIONS. DISCUSSIONS OF U.S. BOOK VALUE (\$83 MILLION) PLUS ONGOING RELATIONSHIP APPROACH FURTHER CONTRIBUTED TO GORWING REALIZATION BY GOP OF ORDER OF MAGNITUDE OF ULTIMALE SETTLEMENT. WE SHOULD HAVE A MUCH BETTER IDEA TOMORROW WHETHER THEY REMAIN INTERESTED IN A QUICK SETTLEMENT DESPITE THE MUCH HIGHER COST THAN THEY HAD HOPED FOR. THE OTHER SHOE HAS FALLEN.

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